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MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

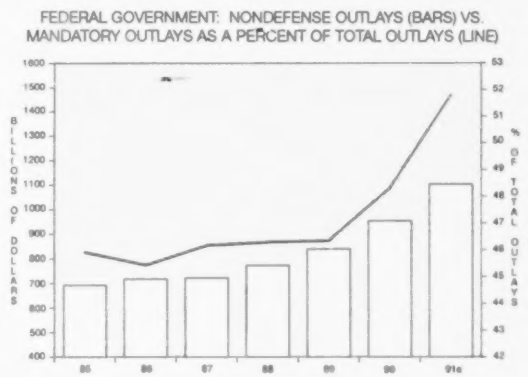
Federal Red Ink At Flood Stage

While the budget woes of the Federal government have recently taken a backseat to concerns surrounding the depth and duration of today's business downturn, the severity of the credit crunch and the ultimate outcome of the Persian Gulf crisis, last week's unveiling of the fiscal year 1992 budget provided a powerful reminder of Washington's financial disarray. For notwithstanding some highly optimistic economic assumptions which help to eliminate the red ink within five years, the nearer-term reality is much less upbeat than the Administration's longer-term hopes.

The President estimates that the deficit in the current fiscal year will soar to a record $318 billion. Fiscal year 1992 is hardly better—a red-ink total of $280 billion is projected. As has been the case for years, the core of the problem remains riveted in the relentless rise of Federal spending and the inability of receipts to keep pace, a by-product of half-hearted deficit reduction attempts, the explosive growth of so-called "entitlement" outlays and the mounting cost of servicing the burgeoning Federal debt.

To be sure, unforeseen events have wreaked havoc with efforts to tame the Federal deficit. Last year, for example, there was a fair degree of optimism within the Administration, if nowhere else, that the fiscal 1991 deficit could be held in the $100 billion neighborhood—until the Gulf conflict started to add "hundreds of millions of dollars" daily to this total, and the onset of recession threatened to add billions more. Nevertheless, it would be a mistake to assume that these factors alone are at the root of the monstrous deficits now emerging. The flow of red ink was headed toward flood stage even in the absence of these developments, and even in the wake of the much ballyhooed, bipartisan budget agreement cobbled together last fall.

Although portrayed as a good-faith effort to tackle rapidly escalating spending levels and burgeoning deficits, the budget accord did neither, certainly not in the current fiscal year and probably not in subsequent ones as well. For one thing, the $22 billion of proposed spending cuts in fiscal year 1991, for example, were to be taken from previously scheduled levels. But, since these levels had already been jacked up



Source: Office of Management & Budget e=estimate

by some $85 billion compared with fiscal 1990, Federal spending was going to vault to a record in the current fiscal year no matter what happened to the economy or in the Gulf region. For another, the proposed $18 billion of tax increases were only playing catch up with the higher spending levels, ensuring that the deficit, too, was on the road to an all-time high.

Some Culprits

The inability of the budget accord to actually reduce the deficit, rather than simply curb its growth, underscores the intractability of the vicious spending circle which plagues Washington and, by extension, the rest of the nation. One culprit is the budget preparation process itself, in particular some of the changes embedded in the budget reform law of 1974. Another is the explosive growth of mandated entitlement spending, making payments to people and businesses who meet eligibility rules set by law, and which has more than offset any actual, and contemplated tapering down of military-related spending.

Take, for example, the impact of the budget reform law of 1974. Under this law, spending levels in each new fiscal year are automatically hiked by some percentage due to inflation and other factors. Only after this is done, does

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Congress tackle the budget. This means that the deck is stacked against those seeking to restore Federal financial health, since any spending "cuts" are taken from constantly escalating spending levels, producing outlay totals that almost always rise, and tax revenues that never seem to catch up with the spending stream. That being the case, the prognosis for diminishing the spending flow is just not good—especially when you consider the ongoing surge in entitlement and other mandated outlays.

While the costs of the Gulf conflict will hike defense spending briefly, this is only a sidebar to the principal problem facing the cost-cutters. Whereas defense spending peaked in inflation-adjusted terms years ago, in fiscal 1987, and declined even in current dollar terms in fiscal 1990, any savings are being more than gobbled up by an acceleration of nondefense spending, which increased by more than 13½ percent in fiscal 1990 alone. This was fueled by a better than 14 percent increase in spending associated with such entitlement programs as Medicare, agricultural subsidies and student loan programs. As shown in the chart, entitlement spending has now surged past the $600 billion mark, accounting for more than half of total Federal outlays. Nor does this include the phoenix-like rise of net interest payments. As

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/23/91)	212,147	- 411	- 5,024
New York City (1/30/91)	34,094	- 1,279	- 7,187
Commercial Paper (1/30/91)	567,507	+ 4,287	+ 36,654

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/23/91)	318,127	- 668	+ 573
New York City (1/30/91)	56,301	+ 78	- 1,184

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/23/91)	1,057,933	- 4,241	+ 58,903
New York City (1/30/91)	174,933	- 1,349	- 6,578

Financial Markets

	Friday 2/8/91	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	6.07%	- .09	- 1.92
180-Day Bills†	6.14	- .08	- 1.94
Longest Bills†	6.17	- .07	- 1.84
Recent Issues:			
7s 1/31/93	6.77	- .04	
7⅛s 1/31/96	7.39	- .06	
7¾s 2/15/01 (When Issued)	7.76	NA	
7¼s 2/15/21 (When Issued)	7.94	NA	
Municipals:			
Bond Buyer—20 Bond Index* (2/7/91)	6.86%	- .14	- .34
Blue List Total ($ Million)	$ 821	- $105	- $ 293
30-Day Visible Supply ($ Million)	$3,369	+ $808	+$2,051
Total	$4,190	+ $703	+$1,758
Corporates:			
Moody's Aa Composite (2/7/91)	9.19%	- .13	- .26
30-Day Visible Supply ($ Million)	$ 505	+ $ 80	- $2,195
Stocks:			
Dow-Jones Averages:			
Industrials	2,830.69	+ 100.00	+182.49
Transportation	1,102.25	+ 38.78	+ 14.06
Utilities	214.66	+ 9.30	- 9.25
65 Stocks	1,014.91	+ 37.13	+ 32.55
N.Y.S.E. Composite Index	196.10	+ 8.70	+ 11.71
N.Y.S.E. Avg. Daily Vol. for Week (000's)	259,755	+ 64,813	+104,609

*34% Taxable equivalent 10.39%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 2/8/91	Week Ago
Overnight	6.34%	6.94%
1 month	6.34	6.69
3 month	6.56	6.63
6 month	6.50	6.63
1 year	6.75	6.88

FOREIGN EXCHANGE SPOT RATES

New York Opening (2/8/91)	Currency Per U.S. $	Week Ago
Belgium	30.02	30.19
Canada	1.1593	1.1605
France	4.9680	4.9930
Germany	1.4590	1.4675
Italy	1097.70	1103.50
Japan	127.90	131.55
Mexico	2966.20	2963.40
Netherlands	1.6440	1.6545
South Korea	707.53	705.16
Switzerland	1.2458	1.2550
Taiwan	26.62	26.63
U.K.*	1.9865	1.9745

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (2/8/91) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.1%	-6.6%

the Federal debt has ballooned, so has its servicing costs, which will be just a shade below $200 billion this year—or more than double the total cost as recently as fiscal 1983.

More Taxes?

In the absence of an effective brake on spending growth, whether or not taxes are an appropriate long-term palliative for today's budget ills is problematic. Over the past five years, nearly $4.6 trillion has been extracted from the taxpaying public, increasing by about seven percent annually, yet the deficit problem not only persists—it has worsened. Nor will putting on the brakes be easy.

Tackling entitlement spending, with sizable domestic constituencies, will require substantial political resolve. All that the "number crunchers" and economists can do is propose reform; legislators must enact it. In this environment, a spending freeze might be ideal if for no other reason than it spreads the pain without distinction. But what is increasingly unacceptable is the tinkering around the edges of these various programs. That approach does little to address the yawning budget deficit, yet does manage to erode confidence, breed cynicism and keep the financial market "bears" well fed. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 2/6/91	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	243.181	- 2.085	+22.320
Loans to Depository Inst.	.087	- .206	- .793
Float	1.221	+ .395	+ .168
Total Reserve Bank Credit	285.556	- .850	+22.591
Treasury Deposits with Federal Reserve Banks	11.182	- 2.881	+ 5.077
Currency in Circulation	282.939	- .187	+29.289
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	255.062	- .310	+25.415
Member Bank Reserves:	**2/6/91**		
Total Reserves Held	60.446	- .241	+ .990
Excess (Deficiency)	2.798	+ 1.880	+ 1.578
Net Free Reserves	2.638	+ 2.576	+ 2.250
Monetary Aggregates †		**‡ % Change Since 3 Months Ago***	**Year Ago**
M1 (1/28/91)	830.1	+ 2.9	+ 3.9
M2 (1/28/91)	3,339.1	+ 1.2	+ 3.2
M3 (1/28/91)	4,144.2	+ 3.4	+ 2.0
Domestic Nonfinancial Debt (3rd Q'90)	10,309.3	+ 7.0	+ 7.5

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 2/8/91	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	5.94%	5.90%	5.86%
* Federal Agencies	6.45	6.60	6.70
* Municipal Notes–High Grade (34% Taxable Equivalent)	6.06	6.82	7.20
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	6.50	6.50	6.68

‡ Finance Company Paper–Prime

5- 14 days	6.27%
15- 29 days	6.30
30- 59 days	6.16
60- 89 days	6.33
90-179 days	6.28
180-239 days	6.05
240-270 days	6.05

‡ Industrial Paper–Prime

30- 89 days	6.33%
90-120 days	6.35

‡* Bankers' Acceptances

Mar.	6.37%
Apr.	6.38
May	6.33
Jun.	6.28
Jul.	6.24
Aug.	6.18

†Federal Funds Effective Rate 5.88%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'90	$ 5,519	$ 5,515	$ 5,289
Gross National Product (1982 Dollars)*	4th Q'90	$ 4,148	$ 4,170	$ 4,133
Percent Change, Annual Rate	4th Q'90	- 2.1	1.4	0.3
Change in Consumer Prices*	Dec '90	3.6%	3.6%	4.8%
Change in MH Cost of Living Index*	Dec '90	4.8%	4.8%	4.8%
Change in Producer Prices*	Dec '90	- 7.2%	6.0%	7.2%
Civilian Employment (Thousands of Persons) †	Jan '90n	116,922	117,574	117,945
Unemployment as % of Civilian Labor Force †	Jan '90n	6.2%	6.1%	5.3%
Personal Income*	Dec '90n	$ 4,747	$ 4,714r	$ 4,497
Leading Indicators Composite Index (1967=100) †	Dec '90n	140.1	140.0r	145.3
Industrial Production Index (1977=100) †	Dec '90	107.1	107.8	108.6
Net Change in Consumer Installment Credit †	Dec '90n	- $ 1.45	$ 2.76	$ 2.72
U.S. Merchandise Trade Balance †	Nov '90	- $ 9.70	- $ 10.99	- $ 9.91
Plant and Equipment Expenditures*	1st Q'91	$ 557.9(a)	$ 532.8(a)	$ 532.4
Private Housing Starts (Thousands of Units)*	Dec '90	987	1,127	1,273
New Construction Expenditures*	Dec '90n	$ 415.1	$ 417.1r	$ 432.0
Total Business Inventories †	Nov '90	$ 816.4	$ 814.3	$ 797.6
Total Business Sales †	Nov '90	$ 545.0	$ 551.6	$ 528.2

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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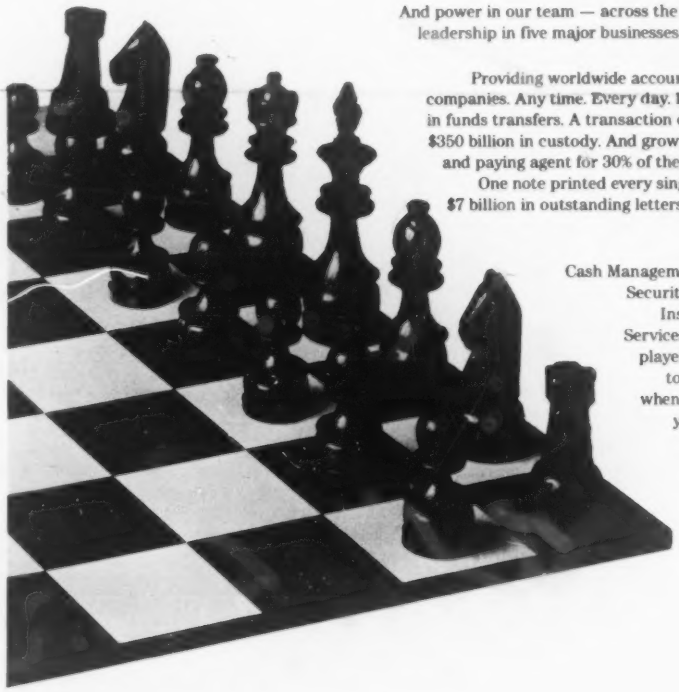

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